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" The Remuneration Committee and Strategic Human Resource Management"

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The Remuneration Committee and Strategic Human Resource Management

Abstract

Manuscript Type: Empirical

Research Question/Issue: The study questions the adequacy of the agency approach in representing how remuneration committees design executive pay arrangements.

Research Findings/ Insights: Using evidence collected from interviews conducted in late 2006 with 22 members of various UK remuneration committees, we find that concerns with legitimacy push remuneration committees towards an institutional isomorphism in processes and practice. The shift in what is expected from remuneration committees - from mainly serving to guarantee the probity of the executive pay process to a recent emphasis on designing remuneration arrangements consistent with the strategic human resource management of the enterprise - has not been fully reflected in committee practice, owing to an overriding desire to seek legitimacy in the eyes of the shareholders and shareholder representative bodies.

Theoretical/ Academic Implications: Any interpretation through an agency lens of the design of executive remuneration as being a key component in the toolbox of strategic human resource management needs to be qualified by considerations of neo-institutionalism. There is scope for a melding of the two approaches.

Practitioner/ Policy Implications: The fulfilment of the expectations placed upon the remuneration committee necessitates an adequate allocation of time and resource plus self-awareness on the part of the committee of the inherent tendency to follow the norms, rules of thumb and customary practice of others. The remuneration committee chair emerges as a pivotal actor, and this position merits being treated as a weighty and onerous appointment, possibly on a par with that of chair of the audit committee.

KEY WORDS: *agency theory; executive pay; neo-institutionalism; remuneration committee; strategic human resource management.*

INTRODUCTION

The problem of creating incentives for the top managers of an enterprise where ownership is widely dispersed has been recognised since the days of the joint stock company (Adam Smith, 1976: 264), and in more modern times gained the label of the problem of “separation of ownership from control” (Berle and Means, 1932: 25). The dominant theoretical approach to the modern version of this problem is agency theory (Jensen and Meckling, 1976), which points to the use of an appropriately designed reward mechanism as a way of aligning the interests of the directors with those of the owners (Murphy, 1999; 38). Even in the broader high-performance human resource management approach (Pfeffer, 1998), the use of performance contingent pay is recognised as a key component. For the top management team or directors of a company, the difficulty of direct supervision by outside directors has long been accepted as creating an obvious locus for the application of such practices and the study of the CEO pay-performance relationship, in particular, has been an actively researched area (Murphy, 1999).

Early estimates of the magnitude of this pay-performance linkage turned out to be empirically modest, which perplexed researchers, given the key importance of the relationship: “Agency theory predicts that an optimal contract will tie the agent’s expected utility to the principal’s wealth; therefore agency theory predicts that CEO compensation policies will depend on changes in shareholder wealth” (Jensen and Murphy, 1990: 242). With empirical estimates pointing to the CEO gaining a mere \$3.25 for every \$1,000 change in shareholder wealth, these authors concluded that CEO compensation was no more variable than the compensation of hourly and salaried employees. And the relative importance of company size in determining CEO led them to suggest that CEOs were paid like bureaucrats. The expanded utilisation of

equity-related pay in boardrooms during the 1980s and 1990s increased these estimated magnitudes somewhat (Hall and Liebman, 1998), and consideration of the risk aversion of directors lowered what might be deemed as empirically significant (Garen, 1994; Hall and Murphy, 2002). Nevertheless, the results of most empirical studies of CEO pay left many observers dissatisfied. In a meta-analysis of some 137 studies of executive compensation, Tosi et al. (2000) found that changes in firm performance accounted for only some four per cent of the variation of CEO pay, and are quite critical of what they perceive to be the over-reliance on archival pay and performance data by studies in this area. They argue that such data provide at best a very partial view of the setting of the CEO's pay and performance arrangements.

Alternative portraits of the executive pay process have been offered. At its most robust, the managerial power approach portrays the effective capture of the board, whereby the compensation committee (or remuneration committee, the term that will be used here) becomes the puppet of the incumbent CEO, undermining any notion of 'arm's length contracting' between the CEO and the board (Bebchuk and Fried, 2004: 61). While producing many arresting and persuasive observations in support of their case, the extent to which these are systematic or even systemic failures remains unclear (Core et al., 2005). An alternative version of this approach, that avoids any assumption of explicit connivance on the part of non-executive directors and attempts to provide a more general perspective, builds on the effects of social psychology, whereby remuneration committee members unwittingly find themselves designing less than optimal remuneration arrangements owing to the subconscious effects of the social influence and reciprocity engendered by their appointment to and position on the board. Such effects are argued to impact on both the level (O'Reilly et al., 1998) and structure (Westphal and Zajac, 1994) of CEO pay.

Stakeholder theory (Mitchell et al., 1997) and stewardship theory (Davis et al., 1997) offer approaches where the dominant self-interest of the directors is held in check, either by the need to balance against other interested parties or through a general recognition on the part of the directors of a wider responsibility.

Gomez-Mejía et al. (2005) argue that in the face of such rival explanations agency theory, nevertheless, retains a measure of over all generalisability. Bruce et al. (2005), in contrast, suggest that neo-institutional theory (Scott, 2001) offers an overarching framework in which to consider all of these perspectives. While rejecting neither the agency nor the managerial power explanations, neo-institutional theory suggests that the way CEO pay is determined may owe much to norms and rules of thumb that have become established practice at any particular time and which tend to perpetuate through repeated use. Whereas in agency theory the remuneration arrangements are seen as designed (by the remuneration committee) solely to optimise the connection between the directors' interests and the interests of the owners, neo-institutional theory views the process as being heavily circumscribed by adherence to customary practice that is 'taken for granted' (DiMaggio and Powell, 1991: 9), and as paying due regard as to what other firms are doing in a form of 'isomorphism' (DiMaggio and Powell, 1983: 149). The driving motivation is not directly to maximise shareholder value but, in a situation beset by issues of bounded rationality (Simon, 1958), informational impactedness and opportunism (Williamson et al., 1975), to reach for a degree of 'legitimacy' (Meyer and Rowan, 1977: 340; DiMaggio and Powell, 1983: 150) in decision making. As a result, remuneration practice is conditioned by the environment in which the firm finds itself (industry practice, norms of behaviour, codes of practice, and so on), with a strong tendency towards imitation.

This produces a greater isomorphism in pay practice than might otherwise be expected. Performance criteria are chosen less because of their linkage with the key success factors of corporate strategy and more because of their common acceptance and use within the sector. Drawing on work by Meyer and Rowan (1977) and DiMaggio and Powell (1983), Eisenhardt (1988) presents one of the best known studies of the neo-institutional theory explanation of remuneration policy by examining the pay-performance relationship in the retail stores of a single shopping mall. This classic study finds support for hypotheses regarding the design of pay that clearly derive from agency theory (e.g., the programmability of the job, span of control, outcome uncertainty) and for hypotheses that are clearly derived from institutional theory (e.g., the age of the store, the product mix), each making a distinct and significant contribution to explaining pay design. The study underscores the importance of both agency theory and neo-institutional theory in explaining remuneration policy in an enterprise.

The current study attempts to follow the injunction of Tosi and Mejía (1989) and look inside the black box of the executive remuneration process by focusing on reported remuneration committee behaviour, rather than relying on archival data concerning pay and performance. Extensive use is made of what has been a recent upsurge in research on the topic of remuneration committees. Because of the very strong institutional influence in this area, the focus is on experience and practice in a single country, in this case the UK. We draw on a series of interviews recently conducted with 22 directors who, among them, serve on the remuneration committees of 35 UK companies. Responses gathered during these interviews are used to evaluate the hypothesis that current remuneration committee practice cannot be understood from an agency theory perspective alone but benefits from recognition of the inertia,

social embeddedness and path-dependence (Scott, 2001) encountered as remuneration committees seek legitimacy under the prevailing regulatory, normative and cognitive influences that condition their actions.

RISING EXPECTATIONS

Remuneration committees emerged as a topic of academic research in the UK as recently as the early 1990s (Main, 1993), although the topic of compensation committees has a longer research pedigree in the USA (Braiotta and Sommer, 1987; Harrison, 1987). While companies, of necessity, have always had a mechanism by which the remuneration of senior executives could be set and adjusted, the arrangement that is now identified with the remuneration committee did not appear in popular discussion in the UK until the work of the Cadbury Committee (1992) created the first discussion of the arrangement in policy circles, and interest has waxed and waned ever since – mostly reflecting subsequent governance reports: the Greenbury study group (1995); the Hampel Committee (1998); and the Higgs report (2003). Each of these further delineated the membership and procedures required of remuneration committees. The Combined Code on Corporate Governance (1998, 2003, 2006) offers a unified and up to date version of these requirements.

The Combined Code requirements operate under the condition (for listing on the London Stock Market) that a company either comply with the code or explain why they are not so doing, the so-called ‘comply-or-explain’ approach. De-listing of the company’s shares by the London Stock Exchange is the only official, and as yet unused, sanction although institutional and media attention also seems to exert an informal pressure to comply. While developments in the European Union and the

OECD may be following the UK example (Pepper, 2006), this is a very different approach from that in the USA with its coercive environment of the legally backed strictures of the Securities and Exchange Commission (SEC, 1993, 2006) and the mandatory conditions for listing on the NYSE (2004) or NASDAQ (2003). In contrast, only in terms of disclosure and the advisory vote has any statutory intervention been made in the UK, and this in the form of the Directors' Remuneration Report Regulations (DTI, 2002), which require detailed reporting of directors' remuneration at a level of detail consistent with the Combined Code.

But what truly distinguishes the UK situation from that in the USA is the way that British institutional investors have been prepared to set about influencing the conduct (as opposed to merely the structure) of the remuneration committee. Institutional investors have been identified for these purposes by Charkham and Simpson (1999, p166) as: the Association of British Insurers (ABI); the Association of Investment Trust Companies (AITC); the Association of Unit Trusts and Investment Funds (AUITF); the Institutional Fund Managers Association (IFMA); and the National Association of Pension Funds (NAPF). It was the introduction of approved executive share option schemes under the 1984 Finance Act that led the institutions to exert their increasingly dominant influence on executive reward. The prospect of equity dilution caused the institutions (and, in particular, the ABI and the NAPF) to issue guidelines as to how such schemes should be administered.

At the outset, these 'Guidelines' (for example, see ABI, 1987) were essentially concerned with regulating the uptake of share-based incentive schemes and imposing (initially) modest performance requirements. The interplay of the Greenbury and Hampel reports and the developing ABI Guidelines has resulted in what have now become annual revisions of those Guidelines. From these, it can clearly be seen that,

step by step, the remuneration committee has been increasingly asked to take responsibility for ensuring that the executive reward structure is aligned with the overall business strategy of the company. Thus,

“Boards should demonstrate that performance based remuneration arrangements are clearly aligned with business strategy and objectives and are regularly reviewed. They should ensure that overall arrangements are prudent, well communicated, incentivise effectively and recognise shareholder expectations.

It is particularly important that remuneration committees should bring independent thought and scrutiny to the development and review process together with an understanding of the drivers of the business which contribute to shareholder value.” ABI (2005, p3)

The advisory vote on the directors’ remuneration report at the AGM, introduced by the Directors’ Remuneration Report Regulations (2002), ensures that the remuneration committee remains under annual pressure to deliver on these expectations. In recent years, commercial ratings services have been developed by both the ABI (as IVIS – Institutional Voting Information Service) and the National Association of Pension Schemes (as RREV – Research Recommendations Electronic Voting). These evaluate, among other things, the Directors’ Remuneration Report (DRR). In the case of IVIS, a traffic light coding is used comprising of blue, green, amber and red, in order of decreasing approval. A company will speak of being ‘red-topped’ or ‘amber topped’, reflecting the IVIS website’s representation of this grading of their DRR and the implied voting recommendation.

In all of this, an important shift has taken place. Whereas remuneration committees were once seen merely as an arms-length administrative device to ensure an acceptable degree of probity in the setting of executive reward, they are now seen as key agents in the strategic human resource management process of choosing a

remuneration package and arranging that it is calibrated in a way that ensures that it incentivises the executive towards those decisions and actions necessary to best deliver the company's chosen strategy (Baron and Kreps, 1999). The remuneration committee thus finds itself tasked with a prime responsibility of remedying or ameliorating the principal agent problem of incentive alignment for members of the top management team (Jensen and Meckling, 1976). It is our hypothesis that the current practices and procedures of remuneration committees cannot be simply understood from the perspective of resolving the principal-agent problem, and that the addition of neo-institutional theory can more fully explain current practice

OBSERVED GAPS BETWEEN OUTCOMES AND EXPECTATIONS

Pettigrew and McNulty (1995) observe that because much discussion of corporate governance has focused on rules, regulations and structures (all easily observable) it has overlooked the important reality of boardroom power and influence, without which it is difficult to comprehend boardroom dynamics and director effectiveness. Landmark quantitative studies of the pay performance relationship in executive reward, including Jensen and Murphy (1990), Hall and Liebman (1998), Conyon and Murphy (2000), and Hall and Murphy (2002), are all guilty of this oversight. Recent interview-based studies of boardroom processes in the UK have set out to remedy this shortcoming. Although much of this work has addressed issues concerning the entire board (Pettigrew, 1992; Pettigrew and McNulty, 1995; Stiles and Taylor, 2000; Pye, 2002; McNulty et al., 2005; Pye and Pettigrew, 2005; and Roberts et al., 2005), there have been a handful of studies specifically examining remuneration committees in the UK (Main, 1993; Conyon et al., 2000; Bender, 2003, 2004, 2007; Ogden and Watson,

2004; Perkins and Hendry, 2005; and Lincoln et al., 2006) and it is upon these that the current investigation builds.

Research questions

From a reading of this literature, four key facets of remuneration committees suggest themselves. These are sketched in Figure 1. The first concerns the remuneration committee business arrangements, including the frequency and duration of remuneration committee meetings. As detailed above, in moving from serving simply as a probity mechanism to being a key player in implementing the human resource management function of linking pay to corporate strategy, there has been a dramatic ratcheting up of the expectations placed on the activities of the remuneration committee. The neo-institutional prediction would be that practice in this area, while conforming to industry practice, will fail to allocate the time or commitment now merited by the task at hand, the process having assumed a taken-for-granted self-perpetuating aspect (Zucker, 1987: 728; Greenwood et al., 2002: 62).

The second aspect of remuneration committee operation considered involves the approach to calibrating the various components of remuneration. This pertains to forming the key linkage between remuneration related performance metrics and the key success factors necessary to deliver company strategy. While such detail would be expected to vary company to company, with both a wide range of metrics observed to be deployed and a varying use made of short term relative to long term remuneration devices, neo-institutional considerations suggest that in the desire for 'legitimacy' remuneration committees will arrive at a convergence of metrics and an isomorphism in remuneration design (DiMaggio and Powell, 1983: 150).

Figure 1 about here

The third area of investigation concerns the extent to which the remuneration committee reviews remuneration outcomes as they are unfolding. With long term incentive devices playing an increasingly important role in the overall package, it becomes increasingly important to take into consideration the way that the already running long term components are developing before considering the appropriate award to make in any particular year (Core and Guay, 2002). From an agency perspective, there is a need to constantly bring the pay-performance relationship back to its optimal level (Core et al., 2005). Neo-institutional theory would predict that remuneration committees focus on conforming to the institutional guidance codes with their reporting emphasis and hence legitimacy focused on current period awards (Scott, 1991:169).

The final area of investigation in this paper concerns the remuneration committee's communication with stakeholders. The nature of the dialogue with the company's executives on the one hand and its institutional shareholders on the other reveals the extent to which the committee is prepared to 'stand up' to institutional pressures in order to secure the optimal remuneration arrangements for the executives and the company. Under the 'comply-or-explain' approach, anything that deviates from the codes of practice, institutional guidelines, or current industry practice requires a conversation to be had with the institutions by way of explanation. Rather than have such conversations, it may appear more acceptable to remuneration committees to seek legitimacy by simply avoiding remuneration practices that deviate in the least way from existing guidelines and practices, no matter what their inside

information regarding company circumstances might suggest to remuneration committee members.

The overall research question, of course, is whether the observed practices and procedures of the remuneration committee are consistent with the challenge of delivering remuneration arrangements that effectively align remuneration (and hence interests) of the directors with the critical success factors necessary for the delivery of company strategy. The alternative investigated here is that the appeal of legitimacy available through following the isomorphism of established institutional practice blunts such possibilities.

Research Design

In order to investigate these conjectures, a series of semi-structured interviews was conducted with members of remuneration committees. Access to the remuneration committee members was gained by announcing the intended research project (in terms of its aim to probe the current remuneration committee process) at various executive remuneration briefing meetings held in London mid-2006. These briefings were part of a regular series conducted by a major consulting firm, where the invitation list was wide and inclusive and not restricted to the client base (essentially being a marketing exercise). Those displaying interest in participating were then followed up and interviewed between 22 September and 15 November 2006. A total of 25 people were identified in this way, although three eventually dropped out owing to illness and other commitments. A certain self-selection bias can, therefore, be expected in the sense that all participants are sufficiently interested in and committed to their remuneration committee responsibilities as to attend briefings meetings and to then go on to volunteer their time to discuss the process in detail with the research team.

The 22 participating directors serve on a total of 68 boards and on 35 of these they sit on the remuneration committee. The distribution of these 35 committees by listing exchange category is as follows: 10 (FTSE100); 10 (FTSE250); 7 (FTSE All Share but not FTSE350); 2 (FTSE – Fledgling); and 6 (Private). On an individual level, of the 22 directors there are 15 who serve as Chair of at least one of their remuneration committees.

Using the FTSE industry classification, the distribution of the 35 remuneration committees by industry of the company is as follows: Oil & Gas 0 (0.00%); Basic Materials 2 (5.71%); Industrials 12 (34.29%); Consumer Goods 3 (8.57%); Health Care 0 (0.00%); Consumer Services 4 (11.43%); Telecommunications 1 (2.86%); Utilities 2 (5.71%); Financials 7 (20.00%); and Technology 4 (11.43%). This is clearly under-representative both in Oil & Gas and in Health Care, and correspondingly over-weighted elsewhere, particularly industrials.

A semi-structured interview approach was adopted (Drever, 2003). The interview pro-forma was developed around one utilised by Conyon et al. (2000), and was sent to each of the interviewees a week or so in advance of the actual interview. Owing to resistance among respondents to the notion of tape recording, a note taker was utilised for all interviews. The note taker was not part of the interview team but circulated the transcribed note to all members following each interview. Practice varies as to the use of tape recording. Bender (2003, 2004, 2007) and Ogden and Watson (2004) taped their interviews, while Perkins and Hendry (2005) and Lincoln et al. (2006) relied on note taking and subsequent transcription of these notes. For those publicly listed companies on whose remuneration committees interviewees sat, it was also possible prior to the interview for the interviewer to read through the relevant Directors' Remuneration Report for publicly available detail regarding

remuneration committee composition and meeting frequency. Some of this detail is discussed later in Table 1.

In addition to email communication and regular meetings of the research team, development of the team's thinking on the subject was aided by a wider discussion of our findings at three points in time. The first took place exactly half way through the interviews in the form of a seminar presentation given as part of the 'Corporate Governance at the LSE' series, where the audience included a mix of academics and professionals from the financial sector. The second event was a dinner held in February 2007 for all interview participants, where the team presented a summary of the findings and invited comment and discussion. Nine of the 22 interviewees were able to attend this discussion dinner. Finally, a draft version of the paper was circulated to all participants for comment.

We now consider in turn each of the four facets of remuneration committee identified above.

The remuneration committee business arrangements

Table 1 utilises data taken from the most recently published annual reports of the companies on whose remuneration committees the interviewees served to reveal that an average of 4.8 remuneration committee meetings were held per year, not too different from the average number of audit committee meetings. Respondents recall these meetings lasting an average of 1.5 hours, with an additional 2.8 hours on average required for preparation. Consistent with this data, interviewees did not report that the workload of the ordinary remuneration committee member was onerous. By way of comparison, it can be noted that Windram and Song (2004) report that in 2000 audit committees among the UK's largest companies were meeting

on average 3.3 times per year with each meeting lasting 2 hours on average and preparation time averaging 5 hours, although this data may understate the current situation as it is pre-IFRS (International Financial Reporting Standards) reforms and pre the Sarbanes Oxley Act (2002).

Table 1 about here

In addition to the actual frequency and duration of meetings, scheduling is a potentially important consideration – whether on a separate day from the Board meeting, coming before, or following after the Board meeting. In all but three cases, committee meetings were reported to be slotted around the main Board meetings, but this was not generally seen as a factor that reduced the ability of the committee to get through the business, and was seen as being an unavoidable logistical consideration. The tight scheduling of committee meetings and relatively brief meetings did, however, lead to feelings of frustration:

“The committee did not spend as much time as it should have done. Wish it had been two hours not one hour. I wish I’d have more time to read papers and interrogate as oppose to philosophical discussions.” Director 18 (Remco member, FTSE All Share)

Lincoln et al. (2006), who focused on some of the more practical aspects of the remuneration committee’s operation, suggest that recruitment to the remuneration committee is not the highest priority in the allocation of boardroom talent. When we probed as to the detail of which directors sat on the remuneration committee, respondents indicated that membership was either a result of sharing out the committee workload across independent directors or a result of a company convention

that all independent directors sat on the committee. While there was no sense in which the remuneration committee was seen as a residual claimant on the talent of the independent directors (e.g., second to the audit committee), membership was seen as requiring general skills rather than any particular expertise in human resources:

“Specialist knowledge is helpful although common sense and judgement is most essential.” Director 13 (Remco Chair, FTSE100)

That said, communication and liaison with the audit committee was recognised as important. To illustrate this point, one respondent recounted how an inconsistent definition of earnings per share had caused problems and that this had been remedied by ensuring that in future there was always at least one member who also sat on the audit committee.

Although the Combined Code clearly envisages the remuneration committee to be a body of independent directors, our interviews revealed that, in reality, most committees actively engage the CEO in the remuneration design and determination process. Indeed, the attendance of the chairman and the chief executive officer (CEO) was generally taken for granted, save at times when their own remuneration was under discussion, and the recent change in the Combined Code (2006) that permits the chairman to be a member of the remuneration committee was welcomed. While an input from the executive was seen as essential, and allowing that in a few cases committees had standing arrangements for an ‘executive-free’ part of each meeting, the involvement of executives could be a source of conflict:

“It’s more inhibited when they’re there.” Director 7 (Remco Chair, FTSE All Share)

This could be stronger, as in:

“We probably erred by having the CEO and chair there almost all of the time.” Director 6 (Remco Chair, FTSE100)

Inhibiting or not, the input of the executives’ perspective was seen as essential, although the involvement of executives in the remuneration process often went beyond information gathering. For some, the process of choosing the structure of the remuneration arrangements had distinct aspects of negotiation about it. The negotiation could be incidental:

“For the direct reports of the CEO, he must have some say, although it does tend to set the framework for his own expectations.” Director 9 (Remco Chair, FTSE250)

Or tacit:

“He claimed he wanted the team to benefit but, when it got down to it, he was the only one in the team.” Director 10 (Remco member, Private)

Or plain explicit:

“Life is one long negotiation with our chief executive. We have a thrusting, dynamic young man who has thrusting, dynamic ideas of remuneration.” Director 5 (Remco member, FSTE250)

But it is generally accepted that to set appropriate incentives it is necessary to have a sense for what will work, and in this respect the view of the CEO was essential in determining whether a particular design was one which promoted the desired behaviour on the part of the executives:

“It’s quite normal for the chief executive to say ‘I feel strongly that X should be in there’. As a remco member I was quite keen on this enthusiasm, getting their buy-in.” Director 18 (Remco member, FTSE All Share)

One finding of our research that appears to have previously been overlooked is the key role played by the chairman of the remuneration committee. In establishing the appropriate relationship on remuneration with the senior executives, the remuneration committee chair was seen to be the key player:

“In one situation, the chair of a remuneration committee looks to me... ‘When we’ve taken a decision, we have taken a decision and do not accept pushback’. The strength of the remuneration committee chairman is important. As long as you are within the parameters of the benchmarking and company policy (e.g. median) most chairs of remuneration committees are quite tough. You need to have been around a bit to be chairman of a remuneration committee.” Director 21 (Remco Chair, FTSE100)

The chair of the remuneration committee also plays a major role in dealing with the various constituencies – both in terms of ‘negotiating’ with the senior management and in terms of liaising with the remuneration consultants and the internal human resources/ compensation and benefits staff function in the company. This makes the remuneration committee chairman’s role a relatively onerous one, both in terms of time and also in shaping the agenda and key proposals put before the committee. As one remuneration committee chair noted in terms of managing the flow of information to the committee:

“It’s important to come with not necessarily a fully-baked cake but you need to know if it’s a fruitcake or a sponge cake and of what shape.” Director 22 (Remco Chair, FTSE250)

The committee members we interviewed invariably made reference to the part consultants play in the process, both in provision of information (e.g., market data) and in putting forward ideas on design. However, remuneration committee chairs, in

particular, also suggested that the HR director (or top reward specialist) also played a vital role in supporting the process.

The important dimensions emerging above are that the remuneration committee is seen as a generalist committee. With the exception of the chair, its meetings are not felt by members to be particularly time consuming, although there is a sense in which longer meetings might prove useful. The committee finds itself negotiating (implicitly or explicitly) with the executive team regarding the shape and size of their remuneration packages and having the CEO in attendance for much of the time is felt inhibiting. In all of this, the chair of the committee is seen to play a key role. There is some evidence here of a path dependence or inertia (Powell, 1991), whereby current committee business arrangements have failed to move beyond an emphasis on probity to reflect the more demanding task of designing the remuneration arrangements required by agency and strategic human resource management considerations.

Having discussed our findings on the business arrangements of the remuneration committees and how they operate, we now turn to examine the detail of remuneration design.

Calibrating the components of remuneration

When it comes to choosing the pay elements and the strength of their links to performance, interviewees recorded a range of opinion, with no small number being quite simply sceptical of the efficacy of the process. This ranges from those who do not regard executives as being driven by such extrinsic rewards (Fehr and List, 2004):

“This motivational business is “phooey”. People do the best job they can. Our LTI is based on the total shareholder return of a comparator group. You’ve no idea

until the end of the three years what the outcome will be. So what can you do? People just do their best.” Director 19 (Remco Chair, FTSE250)

to those who while suspecting that the process is incapable of being designed properly to motivate believe it should at least take care not to de-motivate and, in particular, should ensure in a defensible level of payout:

“One wonders at the end of the day if it motivates but you have to make sure that it doesn’t de-motivate. The company itself should be protected – paying sensible figures for sensible results.” Director 14 (Remco member, FTSE100)

A driving consideration in choosing the remuneration package was how it would appear to institutional shareholders and other outsiders (Bender, 2004), as the following views from three different executives make clear:

“We look at the maxing-out amounts. This is what you have to do for the institutions.” Director 13 (Remco Chair, FTSE100)

“How is this going to look in the annual report when the institutions crawl over it?” Director 9 (Remco Chair, FTSE250)

“..we have the whole mechanism for not rewarding failure rather than seeking to get a genuine incentive.” Director 1 (Remco Chair, FTSE250)

In their interviews of board committee members, Spira and Bender (2004) bring out clearly this source of tension, earlier identified by Tricker (1984) and by Hilmer (1993), that exists within the remuneration committee between ‘Performance’ on the one hand (achieving an effective agency theory type pay mechanism, thereby strategically aligning incentives) and ‘Conformance’ on the other. With ‘Conformance’ the emphasis is very much on being able to demonstrate in an ex-post sense that pay awards conform with the various governance codes reviewed above,

i.e., a monitoring function. In the pursuit of conformance, the remuneration committee is mainly concerned with probity and legitimacy (Meyer and Rowan, 1977; DiMaggio and Powell, 1981). Performance considerations, on the other hand, are more managerial and entail the remuneration committee actively designing remuneration arrangements that both connect with the external reality of the executive labour market (in paying the going rate) and address the agency problem by aligning the interests of the executives with the achievement of the key success factors that underpin corporate strategy (Jensen and Meckling, 1976).

In terms of performance, the remuneration committee plays a key role in the strategic human resource management of the company by crafting remuneration arrangements that attempt to link the interests of the top management team with attainment of the key success factors for corporate strategic success (Stredwick, 2000). From the quotations above, there is obviously a clear tension between the performance role and the conformance role. This finding echoes that of Ogden and Watson (2004, 2006) who, in a series of interviews with remuneration committees of water companies, concluded that these remuneration committees felt highly constrained by political considerations. Such pressures are seen to result in DiMaggio and Powell's (1983) isomorphism in organizational practice, whereby the desire to shape remuneration design in a similar manner to other comparable companies dominates detailed considerations of performance effects.

In our interviews, evidence of a similar desire to conform also emerged when remuneration committee members attempted to explain the relative prevalence of growth in earnings per share (eps) and total shareholder return (tsr) as performance metrics in long term incentive (LTI) awards. The requirement to satisfy outside

commentators rather than any linkage to corporate strategy was usually proffered as a justification. From three interviews:

“[We] used eps due to the lack of anything else we could think was acceptable. We knew the market would be comfortable with eps and we were unsure as to which one [metric] we should be using.” Director 14 (Remco member, FTSE100)

“The obvious metrics of eps and TSR are catch-alls but it’s where you always end up.” Director 9 (Remco Chair, FTSE250)

“Normally I am happy to put my head over the parapet but not in remuneration. I would be slightly cautious as I don’t want to be castrated by the ABI.” Director 22 (Remco Chair, FTSE250)

Some remuneration committee members expressed a frustration at the lack of depth of analysis in the contribution made by their committee to the design of the remuneration package, with a resulting lack of confidence in the result:

“I’m doubtful how incentivising the package is. I think at least once a year we ought to have a fairly open-ended discussion and not too strictly bound by time. I feel the need to have a more strategic meeting: What are we trying to achieve? Is the system too complicated? Is it alright?” Director 4 (Remco member, FTSE250)

Whereas most were satisfied that the performance metrics chosen to operate on the short term incentive (STI - annual bonus) spoke directly to the company’s strategic requirements, there was considerable unease with regard to the long term incentive (LTI). Thus:

“Everyone understands the short-term plan but long-term is an area where executives don’t understand the reward.” Director 1 (Remco Chair, FTSE250)

“I have often found it difficult to see how management conduct and performance has been affected/influenced by LTI.” Director 18 (Remco member, FTSE All Share)

This sharp break between STI and LTI can be seen in Table 2. The performance metrics utilised in the companies where the interviewees sat on the remuneration committee reveal a much richer range in STI (annual bonus) than in LTI (share options and performance shares).

Table 2 about here

In their study of remuneration committees, Perkins and Hendry (2005) made an explicit attempt to examine the extent to which remuneration committees really adhere to the agency theory vision of designing a remuneration package that provides incentives calibrated in the light both of what labour market forces indicate and what corporate strategy requires. An important conclusion of their work is the recognition of the wide range of discretion afforded the remuneration committee in its deliberations (“space for interpretation”, p1446) and that “what matters is how rewards appear, not whether performance is being objectively over-valued” (p1464). The result is that “Ordering top pay may then prove to be contingent more on ‘communication’ than performance management considerations.” (p1464) whereby an isomorphism in practice emerges as a result of a 'socially negotiated consensus' (Greenwood et al., 2002: 59). Again, the dimension of conformance dominates performance considerations and this is confirmed in our findings in terms of LTI design.

But, as in the findings discussed above, remuneration committee members also expressed frustration at the difficulty they confronted in ‘validating’ (Perkins and Hendry, 2005, p1457) the pay-performance relationship set in place, e.g., in terms of the appropriateness or of the line of sight of the chosen comparator companies in long term plans. This we refer to this as the calibration process and, in a world of fast changing and noisy data, it presents the committee with a serious challenge, but one that must be confronted if it is to live up to the ‘performance’ expectation now placed upon it.

Consistent with the findings of Perkins and Hendry (2005) and Bender (2003, 2004, 2007), who conclude that the agency theory perspective provides a distorted vision of what actually occurs in remuneration committees and boardrooms, the findings above point to the empirical impact of wider social processes on the decisions of the remuneration committee producing and isomorphism in practice (DiMaggio and Powell, 1981; Greenwood and Hinings, 1996), undermining the view that remuneration packages are precisely calibrated to reflect labour market conditions.

Of course the main rival explanation to any isomorphism in organizational practice is social learning (Westphal et al., 2001) which can be observationally equivalent. An eloquent expression of this arose in one of our interviews:

“My view is ‘follow with pride’. You need to keep standards up re: techniques and ways of reporting. Copying ideas from other companies is a good thing if they are appropriate. Actively looking outside to see what developments there are. If there’s been a major issue elsewhere then pause for thought Why did that happen? Could it happen to us?” Director 17 (Remco Chair, FSTE100)

While social learning may play a part in the story, the bulk of the evidence presented above calls into question the extent to which remuneration arrangements are designed to attune the interest of the executives to delivering corporate success. The following subsection extends this line of analysis by probing as to the extent to which remuneration committees re-visit earlier decisions in the context of recent experience and their current strategy agenda – the confirming of the remuneration design.

Review of remuneration outcomes

Given the lack of confidence generally expressed regarding the effectiveness of the design process, particularly in terms of the LTI, it is all the more surprising how little account our respondents took of the extant grants of long term incentives held by the executives in the form of deferred bonus arrangements, unvested share options, active performance share plans and so on. Any judgement regarding the precision of the alignment of interests between the top management team and the attainment of corporate strategy must rest, to no small extent, on whether previous incentive grants are currently ‘live’ in the sense of being likely to pay out, and the impact that they are having on current executive behaviours. Core et al. (2005. p1169) label this distinction between the annual award and the total situation of the executive as one between ‘Pay Incentives’ and ‘Portfolio Incentives’.

For short term incentives, monthly information arising out of the regular budget monitoring process was often used to keep sight of likely annual bonus outcomes. However, it was extremely rare to find much effort being made in the remuneration committee to review the long term incentives faced by an executive and, in many cases, surprisingly little was done to apprise executives of how they were faring in terms of likely payout of earlier issues of Long Term Incentives (LTIs).

Prior to 2002, it was common to find both retesting of performance targets and payouts on performance share plans for below median performance but, owing to institutional pressure (manifested, for example, in the ABI Guidelines, at that time), these features are now largely absent. As a result, the long term incentive has become a much more fragile vehicle for delivering performance-related remuneration. This makes the failure to monitor and revisit past long term incentive grants all the more surprising, particularly when coupled with a recognition that the LTI is often not well understood – neither by the recipients nor by the remuneration committees:

“.. executives could not see what they had to do to impact on reward.” Director 6 (Remco Chair, FTSE100)

“They never know from one month to the next if they are in the money or out of the money. There’s no line of sight”.
Director 10 (Remco member)

Although there are, as usual, exceptions to this situation:

“We produce a valuation once a year and we write a note saying ‘you can’t rely on this but this is what’s happening at the moment’ ”. Director 19 (Remco Chair, FTSE250)

Of course, bounded rationality and imperfect information ensure that outcomes may not be at all as expected - due to the particular choice of comparator groups, performance metrics, or performance targets - a situation that is always vulnerable to unanticipated changes in the company’s environment. The evidence from our interviews suggests that with STI the problem is less likely to arise, owing to more accurate calibration with precisely tailored metrics with (and a one year horizon, as opposed to at least three years with LTI).

A key question is whether, mindful of the participation constraint, the remuneration committee is ever prepared to exercise discretion in adjusting the payout or the design of the incentive schemes. The participation constraint arises from the

need to ensure that, whatever the incentive aspects of the remuneration arrangements, executives must see an expected reward that is at least as high as is available in alternative employment, otherwise they will not continue to participate in the offered contract (Gibbons, 2005). Bender (2007) presents detailed evidence of the circumstances under which companies re-design their incentive schemes, generally to better effect a pay out. In many ways, this reluctance to exercise discretion is an unavoidable consequence of the fact that shareholder approval has been sought for the design of share-based LTI schemes, and with boardroom executives usually operating at the maximum limits permitted under such schemes there is actually little scope for discretion. A shareholder vote is then required to change the long term incentive plan. In any case, discretion is something that the remuneration committee member wishes to avoid.

“We’d like to use discretion as little as possible.” Director 1 (Remco Chair, FTSE250)

“Rules are rules.” Director 6 (Remco Chair, FTSE100)

“It’s silly to design a plan and get it approved by shareholders and then go back next year regarding changes.” Director 2 (Remco Chair, FTSE All Share)

When the LTI scheme is seen to fail then the general reaction is to hold a review and re-design the scheme (Bender, 2007) or, in much rarer cases:

“Change the people rather than change incentives. Incentives only work so far”. Director 14 (Remco member, FTSE100)

Lincoln et al. (2006) also highlight the attention (in both time allocated and effort expended) given by remuneration committees to the pay for performance relationship. It requires detailed scrutiny (and re-scrutiny) of the performance of the

company and the performance of the executives. Rather than probe deeply on this issue, it is easy for a remuneration committee to fall back on an isomorphism of organisational practice (DiMaggio and Powell, 1991: 9) and do what everyone else is doing – for example, by setting relative TSR targets for the vesting of options or performance shares, by deferring STI bonus payments into unvested equity, and so on. While the award of any package may be tested against ‘overpayment’ to minimise the risk of incurring Bebchuk and Fried’s (2004: 64) “outrage costs”, the time and resource may not be available to allow a rigorous investigation by the remuneration committee of just which performance targets best ‘fit’ the company’s overall corporate strategy or reflect the current status of the existing tranches of options, performance shares, unvested bonus payments and accrued pension entitlement already awarded to the executive in question.

The willingness on the part of the remuneration committee to confirm the efficacy of the chosen reward mechanisms is of critical importance in the dynamics of executive reward. This conscious movement back to the optimum pay-performance sensitivity lies at the heart of agency theory and is, according to Core and Larcker (2002), the only generally available insight into the causal connection between pay and performance. Key to this view is the notion that companies regularly confirm that the reward mechanisms in place are performing as required. The evidence discussed above suggests that, rather than taking a portfolio view of executive reward, remuneration committees are primarily concerned with maintaining their legitimacy through conforming with regulatory guidelines in terms of current awards. The outcomes of earlier (long term) awards are seldom reported in cash terms, and attention, therefore, focuses on the current year awards. And, as in Ocasio’s (1997:

190) “situated attention”, it is the current year award that is the object of the remuneration committee’s attention.

One further factor that both inhibits the confirmation of the efficacy of the remuneration design and inhibits the adjustment of the design of subsequent awards in the light of that information is the need to communicate with shareholders. It is to this final aspect in the roundel of remuneration committee activity that we now turn.

Communicating with stakeholders

In terms of communication with the central stakeholders in this matter – namely, the shareholders and the executives – a mixed picture emerges. There was a generally robust attitude displayed by most respondents towards communicating with shareholders. This may reflect the fact that, having made every effort to conform, there was little to fear from institutional criticism. Specifically, in terms of the ABI:

“I go and talk to them and they turn out to be pretty sensible.” Director 6 (Remco Chair, FTSE100)

That said, most of those who do contact their shareholders or institutional representatives such as the ABI are generally prepared to make concessions:

“.. gave in to the ABI too easily last time.” Director 5 (Remco member, FSTE250)

“We were prepared to concede a higher target. We had further concessions in the locker that we didn’t have to give.” Director 13 (Remco Chair, FTSE100)

Much rarer (unique in our study) are those prepared to endure the sanction of a poor rating from the ABI:

“If you don’t get a certain number of amber tops then you are not looking after the people!” Director 1 (Remco Chair, FTSE250)

If anything, it is in communication with the executive team where the remuneration committee experiences most tensions:

“A triangular relationship with the company chairman is the best structure - including the remuneration committee and outside advisers. The relationship between the remuneration committee chairman and the chief executive and executive team (business objectives, decision to be median or upper quartile payers,). Lack of engagement between remuneration committee chair and executives is a big problem if it occurs. That’s where the delicate balance is.” Director 22 (Remco Chair, FTSE250)

“I get a sense that directors are becoming rather irritated by being boxed in. They want us to go and see the ABI etc., tell them what we’re doing and put up with the flack.” Director 23 (Remco member, FTSE250)

“Executives, the ABI, shareholders: there’s no alignment of interest. Standing back now after 10 years as a remco chairman – you’re lashed to different sets of horses and being pulled apart.” Director 25 (Remco member, FTSE All Share)

This situation is illustrated in Figure 2 and probably represents the major tension in the remuneration committee. From the evidence above and that of Bender and Spira (2004) and Bender (2003, 2004, 2007) it is the dialogue outside of the company that currently influences most remuneration committee behaviour.

Figure 2 about here

These tensions can be a manifestation of the remuneration committee doing a good job, by designing remuneration arrangements that are both effective and challenging. But they can also be a sign that owing to external pressures an incentive

scheme is imposed that does not offer an effective line of sight between reward and achievement of the critical success factors of the company's business strategy. The attendance of the CEO during much of the deliberation period was noted above. This, combined with the knowledge that the award package will have to be communicated to institutional shareholders, may simply incline the remuneration committee to rely on the defensible and legitimising practice of doing what everyone else is doing – 'the practices and procedures defined by prevailing rationalized concepts ..' (Meyer and Rowan, 1977: 340). But this may not, of course, be what is best suited to any one particular company.

CONCLUSION AND DISCUSSION

Changes in the UK corporate governance environment since Cadbury (1992) have led to increased expectations regarding how remuneration committees should operate. Some of these expectations refer to committee structure and have, more or less, been widely adopted (MacNeil and Li, 2006). Other expectations refer more to the conduct and objectives of the remuneration committee, and represent a serious demand on its capacity. Institutional investors, and the ABI (2005) in particular, have made it clear that they expect the remuneration committee to design and implement reward mechanisms in a such a way as to align the interests of the executives with the attainment of the key success factors necessary for the effective execution of overall corporate strategy. This strategic human resource management task (Baron and Kreps, 1999) represents a material change in scope from the traditional remuneration committee role of guaranteeing the probity of the executive pay process. Agency theory (Jensen and Meckling, 1976) has become the dominant paradigm for theorising

about the executive pay process in this context. It suggests a pay-for-performance reward mechanism as providing a possible answer to the problems of bounded rationality (Simon, 1947), opportunism and information impactedness (Williamson et al., 1975) that beset the effective management of the executive directors.

Agency theory has long been accepted as a useful perspective in the study of organisations (Eisenhardt, 1989), and the setting of executive pay arrangements is an obvious locus for the deployment of such a perspective (Jensen and Murphy, 1990), but the disappointing explanatory power of agency theory in this area, as manifested in many empirical studies of the pay-performance sensitivity of CEO pay (Murphy, 1999; Tosi et al., 2000) suggests that agency theory alone is not capable of fully capturing events. Focusing on the design and operation of the contract can cause researchers to overlook important organisational considerations regarding both the context in which the remuneration arrangements are drawn up and the situation of the remuneration committee itself, as counterparty to the contract. The remuneration committee is not an independent ‘black box’ from which emerges an optimal structure of performance metrics and reward arrangements (Core and Guay, 1999). As with the board itself, it is a social entity. It is necessary, therefore, to recognise the remuneration committee’s cognitive limitations in the face of finite information, bounded computational capacity and restricted time constraints.

Neo-institutionalist analysis of the situation (Meyer and Rowan, 1977; DiMaggio and Powell, 1983; and Scott, 2001) suggests that the actual arrangements may be path dependent and driven by efforts to attain legitimacy, both by mimicking the arrangements of others and by adhering to perceived regulatory norms. These are different forces from the optimisation calculus underpinning agency theory (Garen, 1994; Core and Guay, 1999; Hall and Murphy, 2002; Gibbons, 2005). Any coercive,

mimetic or normative processes that condition the behaviour of the remuneration committee are likely to inhibit the attainment of the consistency and alignment in the available CEO pay incentive levers (the annual bonus plans, share options, performance share plans, deferred bonus arrangements, and so on) that is demanded by strategic human resource management (Baron and Kreps, 1999). In the present study, this is most clearly seen in the manner in which in an isomorphism of practice (DiMaggio and Powell, 1983) is observed in the design of long term incentives (share options and performance share plans) which draw on a markedly more limited repertoire of performance metrics than do the less widely scrutinised or codified short term incentives (annual bonus).

The evidence produced in this paper points to an improved understanding of executive remuneration outcomes being available through focusing not only on the CEO or executives who are in receipt of the remuneration but also on the counterparty to these remuneration arrangements – namely, the remuneration committee. This interview based study of remuneration committee members adds to the mounting evidence produced by Conyon et al. (2000), Bender (2003,2004,2007), Ogden and Watson (2004), Perkins and Hendry (2005) and Lincoln et al. (2006), all suggesting that the dominant paradigm of agency theory may not be capable on its own of fully explaining the observed remuneration arrangements for a company's top executives. The argument presented here suggests developing theory so as to set agency theory within a neo-institutional framework. We have pointed to four distinct areas of the remuneration committee's activities where such interaction is visible, namely in the committee's business arrangements, its efforts to calibrate remuneration with key success factors, the failure to keep the portfolio of remuneration in view, and the tensions raised in communication with stakeholders. In each of these, evidence was

presented to suggest that remuneration committee decisions are socially embedded, and the consequence of customary practice and path-dependence (Scott, 2001).

Committees seek legitimacy for their decisions by recourse to norms and rules of thumb, resulting in an isomorphism of organisational practice that blunts the agency theory based application of performance contingent remuneration so commonly assumed to hold (Meyer and Rowan, 1977; DiMaggio and Powell, 1981).

We find that the business arrangements of a successful remuneration committee depend on more than simply drafting a requisite number of independent directors as members and scheduling some brief meetings. There is a requirement for a significant commitment of committee time and the remuneration committee chair, in particular, plays a key role in managing and coordinating the committee, the top management team, the external advisors and the internal human resources staff to achieve an acceptable outcome for all stakeholders. This role has probably been underestimated and undervalued to date, as practices continue to reflect a time when the main function of the committee was to ensure the probity of the pay process.

There was relatively little emphasis on focusing the remuneration committee on reward outcomes built up over years through a succession of base salary, bonus, long term incentive and pension policies. Each year's reward tended to be treated on its own as a separate event, rather than as the opportunity to 'rebalance' the executive's 'reward portfolio' in the light of recent developments (Core and Guay, 2002). To an extent, this was due to rigidities inherent in having to seek shareholder approval for changes in the LTI, but it was also due to a reluctance to revisit past designs and recalibrate them to reflect current realities. Even in the absence of this consideration, the remuneration committee's calibration of each year's pay award was seen in the area of LTI to rely on a limited range of very similar performance metrics.

These findings point to a propensity on the part of remuneration committees to follow an isomorphism of practice; the aim of this ‘ritual conformity’ (Meyer and Rowan, 1977: 361) being to gain legitimacy for the committee’s actions.

Communication with shareholders and institutions such as the ABI tended to be of more concern to remuneration committees than communication with the top management team. This emphasis on ‘conformance’ over performance (Tricker, 1984; Hilmer, 1993; Spira and Bender, 2004) leads to tensions with senior management, with whom effective communication is often overlooked as attention focuses on the outside stakeholders.

Eisenhardt (1989) emphasised that case based studies always have the limitation of being vulnerable to excessively narrow and idiosyncratic development of theory. One source of possible bias in this study is in the sample selection, which relied on volunteer participants – such remuneration committee members are likely therefore to be more engaged in and thoughtful about the process than randomly selected members. One further limitation of the study is the difficulty encountered in discriminating between an isomorphism in practice owing to mimetic behaviour as predicted by neo-institutional theory as opposed to the outcome of social learning (Westphal et al., 2001). While the overwhelming number of responses pointed to a combination of regulative, normative and cognitive elements determining the observed isomorphic behaviour (Scott, 2001), there was one response (which was reported above) that clearly pointed to social learning. Further work could usefully attempt to follow this up by greater probing in such cases as to the extent to which there was truly any effort to assess the ‘success’ or ‘failure’ associated with the initiatives of particular members of the peer group, as distinct from overall corporate success.

It would also be useful to introduce explicit neo-institutional constructs into the econometric modelling of CEO pay. This can be done either by focusing around changes in the institutional environment (as in Main and Johnson (1993) or Conyon and Peck (1998) which examined the impact of the introduction of remuneration committees in the UK) or through cross-country comparative studies allowing that different local conditions can produce distinct institutionally embedded outcomes (Aguilera and Jackson, 2003; Fiss and Zajac, 2003; Lounsbury, 2007). To date, the comparative approach has been difficult owing to the varying extent of disclosure on executive pay, but this is becoming less of an issue with improvements in practice in many countries (Ferrarini and Moloney, 2005).

The field study described above is based in the UK, but the implications of the importance of institutional influences would seem to apply to a wide range of settings and it would clearly be desirable to replicate this study, particularly in other countries with their own institutions. Pepper (2006) has contrasted the approach to executive pay in individualistic societies (such as the Netherlands, the UK or the USA) as being different from that in communitarian societies (such as France, Germany or Japan). It is argued that in the former the agency theory view of pay as a motivator holds (in theory, if not in practice), while in the latter the emphasis is less on individual self interest and more on corporate social responsibility. While this observation may be taken to suggest that the arguments presented above will be less applicable in some countries, there is an unmistakable movement in the European Union and elsewhere (Ferrarini and Moloney, 2005) towards greater transparency in directors' remuneration, with more attention being paid to the structure and behaviour of remuneration committees. This raises the possibility of a movement in expectations

towards something closer to a pay-for-performance perspective, particularly in the presence of increased cross listing of company shares (Oxelheim and Rondoy, 2005) although convergence in governance practice is far from uniform (Fiss and Zajac, 2004; Collier and Zaman, 2005).

The findings discussed above serve to highlight the importance of the neo-institutional perspective and to caution against context-free applications of agency theory. Those who even consciously set out to design performance contingent remuneration arrangements in the boardroom in an effort to realise the performance consequences of high commitment human resource management practices (Pfeffer, 1998), would be advised to spend time considering the process by which such payment systems are designed and delivered. As suggested by evidence from this and earlier studies (Spira and Bender, 2004; Perkins and Hendry, 2005; Ogden and Watson, 2006; and Lincoln et al., 2006), it seems clear that a neo-institutional perspective can highlight influences that result in remuneration arrangements remaining in practice some distance from what might be predicted by agency theory.

In terms of policy recommendations, it would appear that in addition to a more circumspect attitude on the part of the remuneration committee, attention should be paid to resourcing the crucial role of remuneration committee chair. An increased allocation of committee time (either in duration or frequency of meetings) seems to be merited if the technical aspects of calibrating the LTI with the key success factors of the company's business strategy are to be addressed. Greater attention is called for in examining the entire portfolio of unvested and vested-but-unexercised executive reward when determining the latest year's award. The discretion to fine tune the award package in the light of current circumstances will depend on a willingness to build such flexibility into the design of approved LTI schemes and an acceptance of

responsibility for such actions. Similarly, in communicating with the ABI and other institutions, a more explicit readiness on the part of the remuneration committee to accept responsibility for the reward scheme set in place (and for its implementation) would improve effective communication.

From the interview evidence on UK remuneration committees discussed above, it seems that concerns with legitimacy pushes remuneration committees towards an institutional isomorphism in processes and practice. Given that remuneration committees are no longer simply expected to guarantee the probity of the executive pay process but are now expected to design remuneration arrangements consistent with the successful strategic human resource management of the enterprise, an important consequence of this finding is that remuneration committee practice has not altered as much as might be desirable - owing to an overriding focus by remuneration committees on seeking legitimacy in the eyes of the shareholders and shareholder representative bodies.

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Table 1

Characteristics of Respondents' Board Committees

	Average	Median	Min	Max
Remco members	3.9	4	2	6
Audit Co. members	3.7	4	3	5
Nom Co. members	4.6	5	2	8
Remco meetings per year	4.8	5	1	9
Audit Co. meetings per year	4.4	4	3	12
Nom Co. meetings per year	2.5	2	1	6
Length of Remco meeting (hours)	1.54	1.50	1.00	2.50

Membership and meetings data is taken from the remuneration reports of the 27 FTSE All Share companies on whose remuneration committees the respondents sat. Length of meeting data is averaged over all respondents' recollections.

Table 2: Relative use of performance metrics across schemes

(i) Performance metrics utilised
in annual bonus schemes

N=27 schemes	Number of schemes using this metric	% schemes using this metric
profit	16	59%
earnings per share	9	33%
personal targets	8	30%
free cash flow	4	15%
sales	3	11%
return on capital employed	2	7%
other accounting metric	2	7%
customer satisfaction	2	7%
total shareholder return	2	7%
return on equity	1	4%
budget	1	4%
property price index	1	4%
net asset value per share	1	4%
costs	1	4%
debt reduction	1	4%
reportable injuries per thousand employees	1	4%

(ii) Performance metrics utilised
in share option schemes

N=9 schemes	Number of schemes using this metric	% schemes using this metric
earnings per share growth		
at retail price index +x%	7	78%
relative total shareholder return	1	11%
other	1	11%

(iii) Performance metrics utilised in
performance share schemes

N=21 schemes	Number of schemes using this metric	% schemes using this metric
relative total shareholder return	19	90%
earnings per share growth		
at retail price index +x%	8	38%
cash flow	1	5%
return on invested capital	1	5%
net asset value per share	1	5%
profit	1	5%
other	1	5%

Source: data from the Directors' Remuneration Reports of the FTSE All Share companies on whose remuneration committees the respondents sat.

Figure 1

Stages of Analysis of the Remuneration Committee's Activities

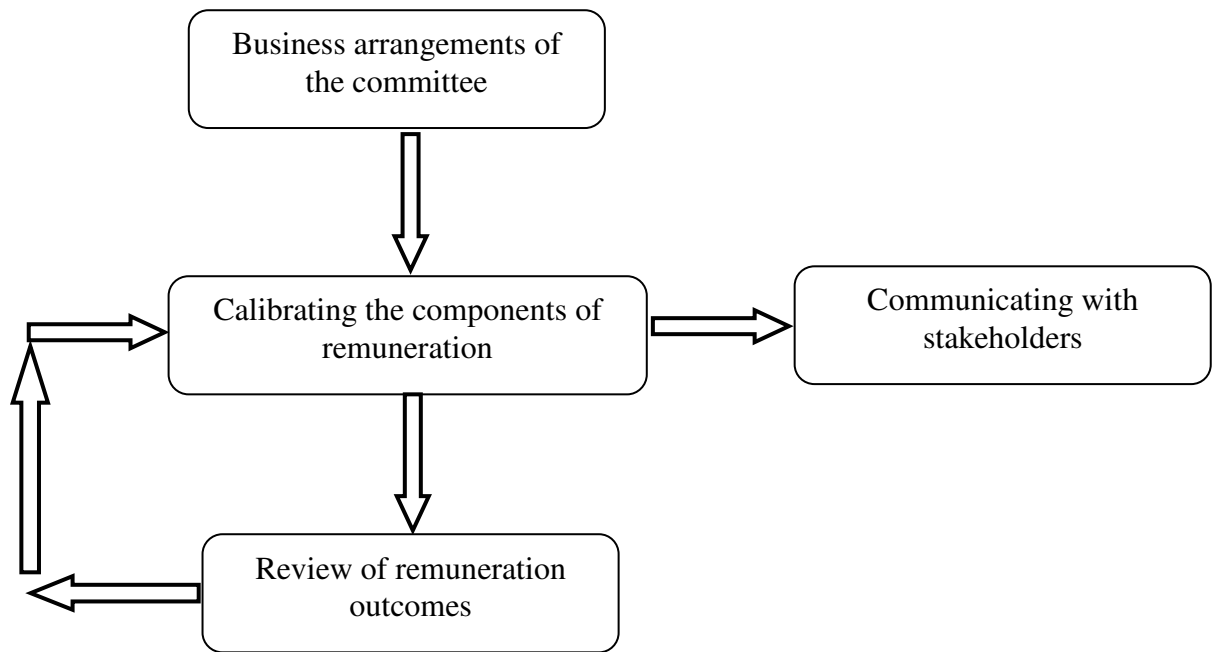


Figure 2

Representation of remuneration committee relationships

